IN THE

Supreme Court of the United States

OCTOBER TERM, 1942

No. ......

TRINITY CORPORATION, *Petitioner*,

v.

COMMISSIONER OF INTERNAL REVENUE, *Respondent*.

BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI.

Opinion Below.

The opinion of the Board of Tax Appeals (R. 22-32) is reported in 44 B. T. A. 1219. The opinion of the Circuit Court of Appeals (R. 100-102) is reported in 127 F. (2d) 604.

Jurisdiction.

The judgment of the Circuit Court of Appeals was entered April 21, 1942. (R. 102-103) The jurisdiction of this Court is found in Section 240 of the Judicial Code, as amended by the Act of February 13, 1925.

Statement of the Case.

The facts are stated in the petition for a writ of certiorari, pages 2-5 hereof, so it will not be repeated here.

Specification of Errors.

The Circuit Court of Appeals erred:

1. In holding that shares of its own capital stock received by the petitioner from its sole stockholder represented something of "exchangeable value" and were, therefore, "income".

2. In holding that shares of its own stock received by the petitioner from its sole stockholder represented "realized gain", although the receipt of such stock merely represented the opportunity to acquire new assets for the petitioner by creating new obligations.

3. In holding that the Commissioner of Internal Revenue could, by a mere change in regulations, completely change the law regarding the tax effect of a corporation's dealings in its own stock.

4. In holding that petitioner's treasury stock, which was required to be held for the benefit of petitioner's sole stockholder for fifty years, and which was in the physical possession of the sole stockholder, could have been sold subject to the fifty-year restriction and had a "fair market value".

ARGUMENT.

"Income" to be Taxable, Must Have "Exchangeable Value."

The taxpayer at all times had but one stockholder, an insurance company. The state insurance examiners "suggested" that the insurance company's ownership of its home office building, through the medium of ownership of all of the stock in the taxpayer, should be changed so that actual title to the building would be in the insurance company. The insurance company had no alternative but to follow the "suggestion" because, if it did not do so, the state authorities would find no difficulty in invoking mandatory power. Consequently, the transactions here involved were consummated. The net result was that the assets of the

taxpayer were reduced by at least $107,850.54 and the assets of the insurance company increased in a like amount, computed as follows:

Before the transaction the taxpayer owned:		
Trinity Building	$617,350.54	
Mortgage	259,900.00	
Equity		$357,850.54
After the transaction the taxpayer owned:		
Reynolds-Penland Building.	$340,000.00	
Mortgage	150,000.00	
Equity	190,000.00	
Cash	60,000.00	250,000.00
Excess of value received over value given		$107,850.54

The petitioner also received 2,920 shares of its own capital stock, subject to the restriction that they must be held and set over to the insurance company if at any time prior to 1987 the ground lease on the ground on which the Trinity Building stood should fail of renewal.

It is obvious that the said stock did not represent "income" because it had no "exchangeable value" for these reasons:

(1) Treasury stock is not a present asset because the taxpayer cannot collect on it. It offers only an opportunity to acquire new assets for the corporate treasury by reissuing the stock. That, in turn, would create corresponding new obligations to the new stockholders.

(2) The restriction on the sale made it impossible to reissue the Treasury stock to outsiders.

The cases interpreting the constitutional permission to tax "income" have consistently held that, unless the thing received has "exchangeable value", it is not income. This is fundamental and established by the earliest income tax de-

cisions. An example is *United States* v. *Phellis,* 257 U. S. 156, wherein it was decided that a dividend paid to a stockholder in one corporation with stock in another corporation was income. The reason was that the stock received had "exchangeable value", which the stockholder could sell for money or retain. Income was defined as (p. 169):

> "a gain, a profit, something of exchangeable value proceeding from the property, severed from the capital however invested, and coming in, that is, received or drawn by the claimant for his separate use, benefit and disposal."

Another way of expressing the same thought is to make the test of income whether the taxpayer has received something out of which to pay the tax or to pay debts. *Commissioner* v. *Moore,* (C. C. A. 10), 48 F. (2d) 526, 529; *Bettendorf* v. *Commissioner,* (C. C. A. 8), 49 F. (2d) 173, 176.

In the case at bar the only way the taxpayer can use the stock to pay taxes or debts is by reissuing it. However, when that is done, an obligation will be created to the new stockholder. The receipt of the stock, therefore, is not within the accepted concept of "income".

Consideration should also be given to the fact the taxpayer and the insurance company:

> "were in substance identical because of the complete ownership and control which the latter possessed over the former, as stockholder and in other capacities. While the two companies were separate legal entities, yet in fact, and for all practical purposes they were merged, the former being but a part of the latter, acting merely as its agent and subject in all things to its proper direction and control." *Southern Pacific Co.* v. *Lowe,* 247 U. S. 330, 337.

Restriction on Sale.

A further reason why the taxpayer realized no taxable gain is that the stock could not be sold to outsiders, due to the restriction. The insurance examiners required that the

stock certificates be delivered to the insurance company and that the stock be assigned to the insurance company, if the ground lease failed of renewal or enjoyment prior to November 30, 1987. Consequently, delivery of the stock could not be made prior to 1897. The Court below held that the stock could be sold subject to the restrictions. Such a conclusion is at such complete variance with actuality as to be absurd. It is fair to assume that no Justice of this Court can recall, or can find, an instance where stock was sold subject to a fifty-year restriction similar to the one here involved. Taxes should be based on what men do, not on some theoretical possibility which, in practice, would not take place.

> "Taxation is an intensely practical matter and laws in respect of it should be construed and applied with a view of avoiding, so far as possible, unjust and oppressive consequences." *Farmer's Loan and Trust Co.* v. *Minnesota,* 280 U. S. 204, 212.

This Court has adopted a practical viewpoint in connection with restricted stock. In *Helvering* v. *Tex-Penn Oil Co.,* 300 U. S. 481, certain stock was received with the oral understanding that it would not be sold while a banking syndicate was selling the remaining stock. The oral restriction was for 90 days and was later extended for an additional 90 days. It was held that the stock had no fair market value, the Court stating (p. 499):

> "the shares of Transcontinental stock, regard being had to their highly speculative quality and to the terms of a restrictive agreement making the sale thereof impossible, did not have a fair market value, capable of being ascertained with reasonable certainty, when they were acquired by the taxpayers."

In the case at bar, the stock was speculative as the company had consistently lost money after the first year of its existence. (R. 25). In addition, the stock could not have been sold to third parties for 50 years, because (1) the tax-

payer was bound to deliver it to guarantee the renewal of the ground lease, (2) until 1987 the taxpayer could not increase, decrease, or change its capital structure and (3) the restriction was required by the state insurance examiners, so had to be obeyed.

The *Tex-Penn* decision is consistent with established law that the purpose of the revenue act is to tax only realized gain. *Helvering* v. *Bruun*, (C. C. A. 8), 105 F. (2d) 442, *Weiss* v. *Wiener*, 279 U. S. 333, 335.

The *Tex-Penn* case has been followed in *Propper* v. *Commissioner*, (C. C. A. 2), 89 F. (2d) 617 and *Schuh Trading Co.* v. *Commissioner*, (C. C. A. 7), 95 F. (2d) 404, which involved restrictions of five years and six months, respectively. In each of those cases, the stock could have been more easily sold subject to the restrictions than in the case at bar. Yet the Court below specifically refused to follow the *Tex-Penn* case because of the entirely illogical, impractical and impossible conclusion that the stock could have been sold subject to the fifty-year restriction.

Fesler v. *Commissioner*, 38 F. (2d) 155, *Newman* v. *Commissioner*, 40 F. (2d) 225, and *Wright* v. *Commissioner*, 50 F. (2d) 727, cited by the Court below (R. 102) as authority for the conclusion that a restriction may reduce, but does not destroy, the fair market value were all decided before this Court's decision in the *Tex-Penn* case.

The Transaction Is Not Taxable Under the Regulations.

Prior to 1934 Treasury Regulations provided that "a corporation realizes no gain or loss from the purchase or sale of its own stock". In 1934 the regulations were amended to read:

> "Whether the acquisition or disposition by a corporation of shares of its own capital stock gives rise to taxable gain or deductible loss depends upon the real nature of the transaction, which is to be ascertained from all its facts and circumstances * * *".
>
> "But if a corporation deals in its own shares as it might in the shares of another corporation, the resulting gain

> or loss is to be computed in the same manner as though the corporation were dealing in the shares of another. So also if the corporation receives its own stock as consideration upon the sale of property by it, or in satisfaction of indebtedness to it, the gain or loss resulting is to be computed in the same manner as though the payment had been made in any other property. * * *"

The basis of the regulation is that taxation "depends upon the real nature of the transaction, which is to be ascertained from all the facts and circumstances".

As previously pointed out, the "real nature of the transaction" is that nothing of "exchangeable value" was received by the taxpayer. The net value of its assets was reduced by the transaction. It received shares of its own stock, but could exchange them for assets for the corporate treasury only by creating new obligations. Obviously, it was a mere capital transaction which could not result in income.

The taxpayer did not deal in its own shares because it is established that a single instance of the acceptance of stock in payment of a debt with a view of their subsequent sale does not "amount to a dealing in stocks". *First National Bank* v. *National Exchange Bank*, 92 U. S. 122, 128. Likewise, an isolated transaction between a corporation and its sole stockholder is not dealing "in its own shares as it might in the shares of another". *E. R. Squibb & Sons* v. *Helvering*, (C. C. A. 2), 98 F. (2d) 69. Judge Foster, in his dissenting opinion in *Allen* v. *National Manufacture & Stores Co.* (C. C. A. 5), 125 F. (2d) 239, says: "In their ordinary meanings 'deals' and 'dealings' imply a course of business or a settled policy".

The case at bar does not come within the rule of such cases as *Dorsey* v. *Commissioner*, (C. C. A. 5) 76 F. (2d) 339, where corporations with numerous stockholders transfer title to a particular asset or assets to one or more stockholders for all of the said stockholders' stock. In such cases the corporation continues with fewer assets, but with one or more stockholders eliminated. In the case at bar,

there was always but one stockholder. Would the "income" have been correspondingly increased if the taxpayer had received 4,999 shares, instead of 2,920 shares, out of the authorized 5,000 shares?

The Commissioner is Without Power to Change a Long-Continued Uniform Construction of a Re-enacted Unambiguous Statute.

It is established that:

> "Treasury regulations and interpretations long continued without substantial change, applying to unamended or substantially reenacted statutes, are deemed to have received congressional approval and have the effect of law." *Helvering* v. *Winmill,* 305 U. S. 79.

From 1918 to 1934 Treasury regulations provided that a corporation realizes no gain or loss from the purchase or sale of its own stock. In 1934 the Regulation was amended to provide for the computation of gain or loss in certain circumstances where a corporation purchases or sells its own stock.

In *Helvering* v. *Reynolds Tobacco Co.,* 306 U. S. 110, and *First Chrold Corporation* v. *Commissioner,* 306 U. S. 117, this Court held the amended regulations could not be retroactively applied to 1929 and 1933 transactions. The Court in the *Reynolds* case specifically refused to decide if the amendment to the regulation were valid when applied prospectively. The case at bar clearly presents this vexing and unsettled question.

In the *Reynolds Tobacco* and *First Chrold* cases, the corporation's stock was purchased and resold. In the case at bar, we are concerned with an isolated acquisition of a portion of the sole stockholder's stock in exchange for a part of the corporation's assets.

The Board of Tax Appeals felt that *Helvering* v. *Reynolds,* 313 U. S. 428, compelled a conclusion contrary to that contended for here. If so, this Court should clarify the rule.

The *Reynolds* case, in dealing with the "reenactment rule", does not specifically overrule the long line of cases concerning unambiguous statutes, such as *Haggar Co.* v. *Helvering*, 308 U. S. 389, which states (p. 398):

> "It is a familiar doctrine that Congress, by re-enacting a section of the revenue act without change, approves and adopts a consistent administrative construction of it."

The *Reynolds* case dealt with an admittedly ambiguous phrase[1] so, because of the lack of specific language overruling prior cases, it must have been intended to apply only to cases where ambiguity exists.

In the case at bar, section 22 (a) is a definition of income and certainly is not ambiguous.

> "The legislative intent appears clearly expressed to include all receipts and increments of every kind and nature, which, under the particular circumstances of their realization, represent in fact *income within the meaning of the Sixteenth Amendment of the Constitution.*
>
> "It is thought that a definition expressing clearly such meaning requires no interpretive regulation to clarify an ambiguity but merely to explain and call attention of subordinate administrative officers and taxpayers to those transactions which from their nature do not result in income within the meaning of that term as used in the Sixteenth Amendment and defined in *Eisner* v. *Macomber*, or which are exempt from federal taxation as imposing a burden upon state sovereignty. Such an explanatory regulation would not directly concern the meaning of the *definition* of 'gross income' in Section 22 (a), but would relate to the meaning of the term 'income' as used in the Sixteenth Amendment and to the *constitutional restrictions thereof.*"[2]

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[1] "Its meaning in this statutory setting was far from clear." P. 433.

[2] John B. Olverson, Jr., "Tax Regulations and the Reenactment Problem". Georgetown Law Journal, Washington, D. C., March, 1942. The said article exhaustively discusses the entire problem suggested by its title.

If this Court has overruled the re-enactment rule, it means that much of the certainty has passed out of administrative law. No longer can citizens, or their attorneys, rely on long and consistent administrative and judicial interpretation of a statute. If they do, they may find that an administrative official has changed the rule after the particular transaction has occurred, irrespective of the effect on the particular citizen's person or property. And, of course, there is nothing to prevent administrative officers changing their position from year to year in the light of changing or passing public opinion. It is hard to believe that this Court has made such a drastic change in established law without specifically pointing it out by overruling prior decisions. But, no matter what was decided in the *Reynolds* case, it has no application to the facts in the case at bar, because there was no gain and because "the real nature of the transaction" provisions of the Regulation so declare.

The Decision Below is in Conflict With a Decision of this Court and With Decisions of Two Circuit Courts of Appeal.

The decision below is in direct conflict with the following decisions:

> *Helvering* v. *Tex Penn Oil Co.*, 300 U. S. 481, discussed at page 15, supra;
> *Propper* v. *Commissioner*, (C. C. A. 2) 89 F. (2d) 617, and
> *Schuh Trading Co.* v. *Commissioner*, (C. C. A. 7) 95 F. (2d) 404, discussed at page 16, supra.

The petition in this case should be granted to resolve the confusing conflict occasioned by the decisions mentioned.

CONCLUSION.

For the reasons stated, the petition for a writ of certiorari should be granted.

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